Regulations governing international settlement rates, then the ITU Convention requires the United States to resolve the international settlement rates dispute through a method mutually agreed to by the other parties, rather than by means of unilateral action.

C. The NPRM's Proposals Would Expose The United States To International Claims For Compensation And Dispute Arbitration Under Numerous Treaties And International Law

Adopting the proposed "enforcement actions" would expose the United States to expropriation and compensation claims by foreign carriers themselves under bilateral investment treaties ("BITs") between the United States and various countries. They would also expose the United States to dispute resolution proceedings with the foreign carriers and the governments of the countries in which they operate.[52/]

First, the NPRM's proposals would expose the United States to expropriation and compensation claims and dispute resolution proceedings under numerous BITs. Under these proposals, the U.S. Government would expropriate the investments of foreign carriers in violation of the BITs concluded between the United States and numerous other countries.[53/] These BITs protect foreign investors

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[52/] The U.S. Government would also be subject to diplomatic efforts contesting the NPRM's proposed settlement rate practices, including espousals of claims by foreign governments on behalf of the foreign carriers.

[53/] As of the beginning of 1996, the United States had concluded BITs with Argentina, Armenia, Bangladesh, Brazil, Bulgaria, Cameroon, Congo, the Czech Republic, Egypt, Grenada, Kazakhstan, the Kyrgyz Republic, Moldova, Morocco, Panama, Poland, Romania, Russia, Senegal, Slovakia, Sri Lanka, Tunisia, Turkey, and Zaire. See United States Dep't of State, Treaties in Force (1996); Kenneth J. Vandevelde, U.S. Bilateral Investment Treaties: The Second Wave, 14 Mich. J. Int'l L. 621 (1993). These BITs are based on the Model BIT, which serves as the basis for the continuing Bilateral Investment Treaty Program of the U.S. Department of State. See Model Agreement Between the Government of the United States of America and the Government of *** Concerning the Encouragement and Reciprocal Protection of Investment, art. III(1) (on file with the U.S. Dep't of State Office of Investment Affairs, Jan. 1997) ("Model BIT")

from expropriation and require compensation in the event of expropriation. The settlement payments owing to foreign carriers constitute investments protected under numerous BITs. The Model BIT provides that:

> Neither party shall expropriate or nationalize a covered investment either directly or indirectly through measures tantamount to expropriation or nationalization . . . except for a public purpose; in a non-discriminatory manner; upon payment of prompt, adequate and effective compensation; and in accordance with due process of law. . . .[54/]

The BITs consistently define contract rights as investments subject to protection.[55/] In the present case, the rights of foreign carriers to receive settlement payments pursuant to carrier-to-carrier contracts would be constitute "contractual rights," "intangible property," "claims to money," and "rights conferred by contract" subject to protection as investments.

For those BITs that define an investment as having a situs, the settlement payments owing to foreign carriers under carrier-to-carrier contracts would have a legal situs in the United States.

54/ Model BIT, art. III(1); see Treaty Between the United States of America and the Argentine Republic Concerning the Reciprocal Encouragement and Protection of Investment, art. IV (1), Nov. 14, 1991, S. Treaty Doc. No. 103-2 (1993) ("U.S.-Argentina BIT") (substantially the same).

55/ See, e.g., Model BIT, art. I(d) ("'[I]nvestment' of a national or company means every kind of investment owned or controlled directly or indirectly by that national or company, and includes investment consisting or taking the form of . . . (iii) **contractual** rights, such as under turnkey, construction or management contracts, production or revenue-sharing contracts, concessions, or other similar contracts . . . and (vi) rights conferred pursuant to law, such as licenses and permits.") (emphasis added); U.S.-Argentina BIT, art. 1(a) ("[I]nvestment means every kind of investment in the territory of one Party owned or controlled directly or indirectly by nationals or companies of the other Party . . . and includes, without limitation: (i) tangible and intangible property, including rights, such as mortgages, liens and pledges; . . . (iii) a claim to money or a claim to performance having economic value and directly related to an investment; . . . and (v) any right conferred by law or **contract**.") (emphasis added).

> [I]n the case of credits, though intangible, . . . the control adequate to confer jurisdiction may be found in the sovereignty of the debtor's domicile. The debt, of course, is not property in the hands of the debtor; but it is an obligation of the debtor and is of value to the creditor because he may be compelled to pay; and power over the debtor at his domicile is control of the ordinary means of enforcement.[56/]

Thus, foreign carriers would have payments due under contract, i.e., credits, within the territory of the United States and could seek the protection under various BITs.

The BITs provide for arbitration of disputes arising thereunder, with the preferred remedy being arbitration before the International Centre for the Settlement of Investment Disputes ("ICSID").[57/] ICSID arbitration, if elected by the aggrieved party, is compulsory if both parties are signatories to the ICSID Convention, as the United States is.[58/]

Second, the NPRM's proposals would expose the U.S. Government to expropriation and compensation claims and dispute resolution proceedings under numerous other treaties and customary international law.[59/]

As discussed above, the bilateral investment treaties would subject the U.S. Government to compulsory ICSID arbitration. Nationals of other parties to the ICSID Convention may compel arbitration with the United States for any violation of the Convention entirely independent of any BIT.

[56/] Liverpool & London & Globe Ins. Co. v. Board of Assessors for the Parish of Orleans, 221 U.S. 346, 354 (1911).

[57/] See Model BIT, art. IX(3)(a).

[58/] Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, Mar. 18, 1965, 17 U.S.T. 1270, 575 U.N.T.S. 159 (entered into force definitively for the United States on Oct. 14, 1966) ("ICSID Convention").

[59/] The binding nature of these agreements is independent of the ITU Convention, which obligates the United States and other ITU members to arbitrate their disputes regarding ITU matters pursuant to other bilateral and multilateral arbitration agreements.

The United States would also be subject to arbitral proceedings under "Bryan treaties."[60/] The Bryan treaties allow a party, in the absence of diplomatic or other arbitral remedy, to submit any dispute, regardless of its nature, to a Permanent International Commission constituted pursuant to the treaty.[61/] The United States itself invoked a Bryan treaty in 1989 to resolve a dispute with Chile.[62/]

III. THE COMMISSION SHOULD REQUIRE COST-BASED INTERNATIONAL COLLECTION RATES BEFORE IT REQUIRES COST-BASED SETTLEMENT RATES

AT&T has asked the Commission to impose cost-based rates on every international carrier in the world, except for the American ones. While the NPRM asserts that foreign carriers have settlement rates that are on average $0.29 per minute above incremental costs,[63/] the U.S. carriers enjoy international collection rates that are on average $0.55 per minute above international costs, as shown in Table 1, below. Thus, the margin above incremental cost for U.S. carriers is nearly twice as large as for

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60/ These countries include Australia, Bolivia, Brazil, Chile, Denmark, Ecuador, France, Iceland, Italy, Norway, Paraguay, Portugal, Russia, Spain, Sweden, Taiwan, the United Kingdom, Uruguay, and Venezuela. See United States Dep't of State, Treaties in Force (1996).

61/ U.S.-Spain Bryan Treaty, art. 1 (in absence of diplomatic or other arbitral remedy, allowing the parties to submit "[a]ny disputes arising between the Government of the United States of America and the Government of Spain, of whatever nature they may be" to a Permanent International Commission constituted pursuant to the treaty).

62/ Marian Nash Leich, U.S. Practice, 83 Am. J. Int'l L. 348, 352 (1989) (discussing U.S. invocation of the Bryan treaty between the United States and Chile to resolve the "Letelier dispute").

63/ The NPRM states that the average settlement rate is $0.365 per minute (¶ 26), and that the average network cost is $0.075 per minute (¶ 51), leaving a claimed margin of $0.29 per minute above incremental cost. Telefónica Internacional accepts the NPRM's data, including the average network cost figure, for the purposes of argument in Part III only. In Part VI, Telefónica Internacional demonstrates that this average network cost figure is not accurate for most foreign carriers.

foreign carriers. Moreover, international settlement costs have fallen by 48% since 1987, reducing the margin for foreign carriers and increasing the margin for U.S. carriers.

Vice President Gore told the ITU Development Conference in Buenos Aires, "we need to adopt cost-based collection and accounting rates."[64/] Until the FCC requires U.S. carriers to charge U.S. consumers cost-based collection rates, the Commission is in no position to attempt to impose cost-based settlement rates on foreign carriers.

The high price-cost margins enjoyed by U.S. carriers on international routes are shown in Part III.A. The implications of these high price-cost margins for this rulemaking are considered further in Part III.B.

A. U.S. Carriers Enjoy High Price-Cost Margins On International Collection Rates

The FCC's data establishes that the U.S. carriers have substantial price-cost margins (the difference between price and incremental cost). The NPRM states that the average collection charge is $0.99 per minute,[65/] the average settlement cost is $0.365 per minute,[66/] and the average network cost is $0.075 per minute.[67/]

64/ Vice President Al Gore, Remarks Prepared For Delivery At The International Telecommunications Union Meeting in Buenos Aires, Argentina (Mar. 21, 1994), reprinted in 54 Daily Executive Rep. (BNA) M-1, M-2 (Mar. 22, 1994) ("Gore ITU Speech").

65/ NPRM ¶ 9.

66/ Id. ¶ 26.

67/ Id. ¶ 51 (relying on AT&T assertion).

Based on the Commission's data, U.S. carriers' have an average price-cost margin of $0.55 per minute on international calls, as shown in Table 1.[68/]

Table 1	
U.S. Carrier	
Collection Revenues	$0.99
Settlement Cost	-$0.365
Network Cost	-$0.075
Price-Cost Margin	$0.55

The substantial price-cost margins on U.S. international routes are confirmed by a recent study performed by Professor Paul MacAvoy.[69/] Professor MacAvoy found that price-cost margins on major U.S. international routes generally exceeded 70% by 1994.[70/] According to Professor MacAvoy, the price-cost margins for

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[68/] Indeed, the additional return traffic revenues that U.S. carriers earn from originating an additional minute of IMTS traffic should be included in the calculation of the price-cost margin. For each minute of outgoing traffic, a U.S. carrier receives $0.185 in additional revenues from foreign carriers for return traffic. FCC, 1994 Section 43.61 International Telecommunications Data, Table A20 (1996). Subtracting the average network cost of $0.075 for this return traffic, leaves net return traffic revenues of $0.11 per minute of outgoing traffic. Accordingly, a U.S. carrier's price-cost margin for providing IMTS is actually $0.66 per minute ($0.55 + $0.11).

[69/] Paul W. MacAvoy, The Failure of Antitrust and Regulation to Establish Competition in Long-Distance Telephone Service 157-74 (1996). Portions of the international study in the book were originally undertaken by Professor MacAvoy in his study presented to the Commission on behalf of Telefónica Larga Distancia de Puerto Rico, Inc. ("TLD") in the Foreign Carrier Entry proceeding. See Reply Comments of TLD at Exhibit A (May 12, 1996) (IB 95-22). Professor MacAvoy's Foreign Carrier Entry Study is hereby incorporated into these Comments by reference.

[70/] MacAvoy, The Failure of Antitrust and Regulation at 164-65. The principal difference between the calculation of the $0.55 price-cost margin above and Professor MacAvoy's calculations is that he properly includes U.S. carriers' revenues for return traffic from foreign carriers in his calculations of the price-cost margin, as explained above. See id. at 163.

international MTS and WATS services were more than double the average price-cost margins in other concentrated industries:

> Those MTS and WATS margins also exceeded levels found in concentrated manufacturing industries in the United States. In a sample of 284 U.S. industries in 1981, the average price-cost margin was 27.5 percent, or less than half the value found for most of those standard or discount international markets. In addition for the group of industries in that sample having the highest market concentration (the top four firms accounting for at least 81 percent of sales), the average price-cost margin was 33 percent or still less than half that in most of those international markets.[71/]

Not only are these price-cost margins unusually large, but they have been increasing over time as the U.S. carriers have benefited from declining costs. As shown in Figure 1, weighted average settlement rates peaked in 1987 at $0.70 per minute.[72/] Since then, settlement costs for U.S. carriers have decreased 48%, to $0.365 in 1996.[73/] Indeed, since 1990, the average annual settlement rate decrease has been 8.4%.[74/] Since these figures have not been adjusted for inflation the real decline in settlement costs has been even greater.

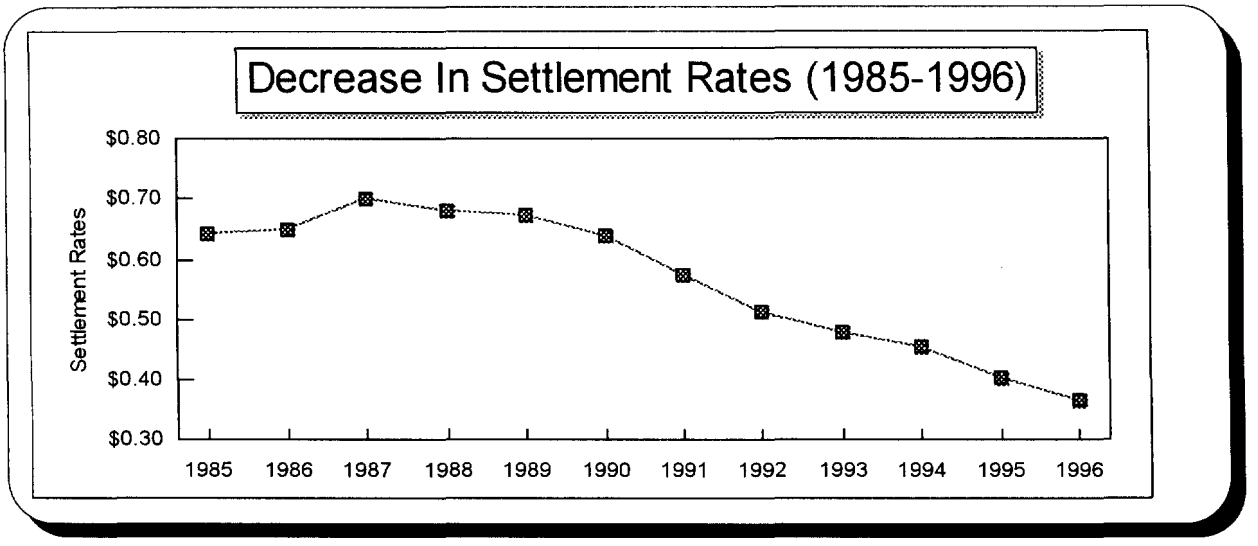
[71/] Id. at 166 (citing I. Domowitz, R. Hubbard & B. Peterson, Business Cycles and the Relationship Between Concentration and Price-Cost Margins, 17 Rand J. Econ. 1 (1986)).

[72/] FCC, Accounting Rates For International Message Telephone Service Of The United States 6 (Dec. 1, 1996).

[73/] Id.

[74/] Id.

Figure 1



During the same period that settlement costs fell 48%, local access charges have fallen 51%.[75/] And, as the NPRM points out, improved technology has also decreased network costs.[76/]

Professor MacAvoy's study, examining the eight largest U.S. outbound country pair markets between January 1990 and December 1994, concluded that these falling costs led to increasing margins for U.S. carriers who failed to pass all the cost savings through to consumers:

> Price-cost margins for standard services across the eight largest country pair markets in general were high, and they increased substantially in the first half of the 1990s.[77/]

Since the end of 1994, the trend has become even more ominous for the U.S. consumer. Settlement rates decreased 19.8% in 1995 and 1996.[78/] However,

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[75/] Monitoring Report, Table 5.11 at 474 (CC 87-339) (May 1996).

[76/] NPRM ¶ 9.

[77/] MacAvoy, The Failure of Antitrust and Regulation at 164.

[78/] FCC, Accounting Rates For International Message Telephone Service Of The United States 6 (Jan. 1, 1997).

AT&T recently responded to these continuing **decreasing** settlement costs by **increasing** its international rates by an average of 4.8%.[79/]

B. The FCC Must Impose Cost-Based Rates On U.S. Carriers Before Attempting To Do So On Foreign Carriers

The margins for AT&T and other U.S. carriers are so large that they are nearly double those of foreign carriers. AT&T has tried to focus attention on the settlement rates to divert Commission attention from the much larger problem for U.S. consumers -- AT&T's high margins.

The fundamental premise in this rulemaking is that U.S. consumers pay too much for international calls: "U.S. consumers pay on average 16¢ a minute for a domestic long distance call, but they pay 99¢ a minute for an international call."[80/] The NPRM acknowledges that "[t]he difference is attributable in part to limited competition in the IMTS market and in part to the inflated settlement rates paid by U.S. carriers to terminate traffic in foreign markets."[81/]

Indeed, it is instructive to look closely at how much of the $0.99 per minute paid by American consumers goes to the margin of U.S. carriers because of "limited competition in the IMTS market," and how much goes to the foreign carriers

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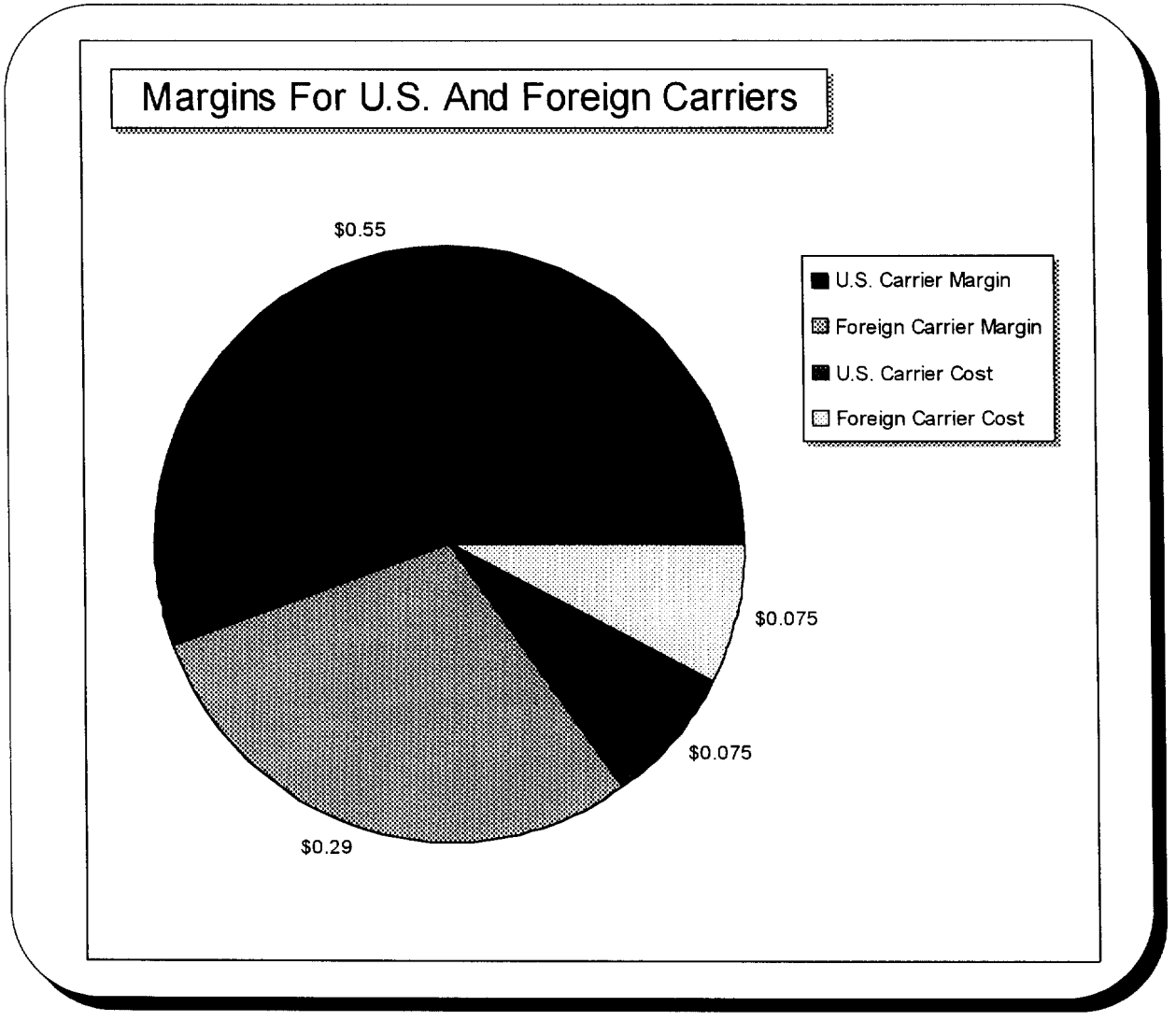
79/ John J. Keller, AT&T and Rivals Boost Rates Further, Wall St. J. Nov. 29, 1996, at A3. The Journal notes that "[o]verall, AT&T has raised its basic [domestic] rates by 22% since January 1994. Its two biggest rivals, MCI and Sprint have followed suit." Id. AT&T also increased its international rates to selected countries between 6% and 15% in November 1995. See AT&T Intends to Increase Prices of International Services, The Legal Intelligence, at 10 (Nov. 7, 1995).

80/ NPRM ¶ 9.

81/ Id. The contrast between the careful description of the United States IMTS market as having "limited competition" while referring to the "inflated settlement rates" is unfortunately characteristic of the NPRM.

because the settlement rate is "above cost." Figure 2 shows that U.S. carriers get almost twice as much of the joint margin ($0.55) as foreign carriers ($0.29).

Figure 2



Under the Commission's long run incremental cost model, there is no economic justification for U.S. carriers to have greater margin than foreign carriers on U.S. outbound calls. Applying the NPRM's total service long run incremental cost ("TSLRIC") methodology to both ends of the call, the U.S. carrier and the foreign carrier

would recover $0.075 per minute each and the consumer would pay $0.15 per minute.[82/]

The clear implication of AT&T's settlement rate proposal is that the inevitable decline in settlement rates enjoyed by U.S. carriers over the past decade would accelerate. U.S. carriers would capture ever increasing proportions of the joint margin on outbound international calls.

The Commission must require U.S. carriers to set prices at incremental cost before requiring foreign carriers to do so for three important reasons. **First**, U.S. consumers would benefit from lower collection prices, not necessarily from lower settlement costs. U.S. carriers already capture about two-thirds (and growing) of the joint margin on outbound international calls. U.S. carriers, however, give only about one-sixth of these settlement cost savings back to U.S. consumers. If regulatory intervention is warranted, then the Commission should attack first the collection rates charged to U.S. consumers, which include nearly two-thirds of the joint margin, before focusing on the one-third of the margin belonging to the foreign carrier.

Second, settlement rates have fallen 48% since 1987, and continue to decrease at an annual rate in excess of 8%. These declines are attributable largely to: (1) increasing worldwide competition; (2) multilateral efforts of the ITU, OECD, and others; (3) the Commission's existing benchmarks and jawboning efforts; and (4) the persistent efforts of U.S. carriers. Meanwhile U.S. carriers' price-cost margins and collection rates are increasing. If regulatory intervention is warranted, then the

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82/ The Commission's incremental cost analysis ignores capital costs, which are significantly greater for foreign carriers than for U.S. carriers on a per minute basis. The incremental cost analysis also ignores marketing and other overhead costs, some of which might fall disproportionately on the originating U.S. carriers. However, AT&T's marketing expenses were only approximately $0.025 per minute in 1993. MacAvoy, The Failure of Antitrust and Regulation at 173. As explained below, the NPRM's calculation of incremental costs for foreign carriers requires significant corrections.

Commission should attack first the **increasing** collection rates and margins enjoyed by U.S. carriers, before concentrating on the **decreasing** settlement rates and margins of the foreign carriers.

Third, it would be hypocritical for the Commission to insist that foreign carriers set their prices at (or even move towards) incremental costs without first requiring U.S. carriers to do the same. If regulatory intervention is warranted, then it should begin at home -- where the bigger problem is.

IV. THE UNITED STATES SHOULD RELY ON BILATERAL AND MULTILATERAL PROCESSES TO REDUCE SETTLEMENT RATES

The United States should not impose settlement rates on other countries, but rather should continue to rely on the bilateral and multilateral efforts which have already achieved demonstrable success in lowering rates world-wide. Any unilateral effort to impose new settlement rates on foreign countries not only abrogates the contractual agreements on which current rates are based, but does so in a manner which largely disregards the legitimate interests of foreign countries and undermines the progress that international efforts have made to date.

Instead, the Commission should continue along the course it has already charted elsewhere -- a course that relies on market forces and international efforts to foster a truly competitive global market. For ultimately it is only the rigors of a competitive marketplace, and not unilateral FCC action, that can ensure that settlement rates are truly cost-oriented.

A. Multilateral Efforts And Market Forces Are Working To Bring Down Settlement Rates

Multilateral efforts and market forces are already succeeding in significantly lowering settlement rates. U.S. settlement rates with the United States have fallen 48% in nominal terms since 1987.[83] This is considerably more than U.S. international collection rates have declined.[84]

Moreover, there is every indication that this success will continue at an even faster pace. As the FCC approvingly catalogues in its NPRM, international efforts are multiplying: both the ITU and the OECD have reached consensus on the need to reduce settlement rates, Mexico and Sweden have explored settlement rate reform, and the United States and the United Kingdom are actively attempting to improve settlement rate transparency.[85] Moreover, the European Union is considering replacing the current system of settlement rates in favor of a system of interconnection charges.[86]

Competition is also growing in the IMTS market. As the NPRM noted, "many countries are rapidly moving from the old model of monopoly providers to competitive markets for telecommunications services."[87] In addition, the WTO is on the verge of reaching an agreement liberalizing telecommunications trade, and Europe is expected to open its telecommunications markets next year. These breakthroughs will join market innovations, such as third country routing and Internet telephony in putting downward pressure on settlement rates. Indeed, such increased competition is the key

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83/ FCC, Accounting Rates for International Message Telephone Service Of The United States 6.

84/ MacAvoy, The Failure of Antitrust and Regulation at 164.

85/ NPRM ¶¶ 15-16.

86/ Id.

87/ Id. ¶ 14.

to lower settlement rates. As the Commission itself has acknowledged: "[I]ncreased global competition will encourage foreign carriers to move accounting rates towards cost-based levels."[88/]

The Commission has also done much to foster the competitive global telecommunications market that is beginning to take shape. Only just recently the Commission issued its Flexibility Order,[89/] which concluded that it was no longer necessary to apply the Commission's international settlements policy ("ISP") on competitive routes. In doing so, the Commission stated:

> This conclusion is consistent with our policy of allowing market forces, where possible, to determine the allocation of resources. Moreover, allowing flexibility in the ISP is the best support for development of more competitive market structures and therefore should not be unduly restricted.[90/]

The Flexibility Order reflects the Commission's basic approach to the international market: encourage market forces to work by permitting competitive forces to shape the settlements process. As the Commission concluded, these competitive forces will do much to bring down settlement rates in competitive countries:

> We therefore conclude that creating a more flexible regulatory framework at this time will serve our objectives to promote competitive behavior, improve economic performance, and rely on competitive market forces to determine call termination charges to the maximum extent permitted by market conditions.[91/]

88/ In the Matter of Market Entry and Regulation of Foreign-affiliated Entities, 11 FCC Rcd. 3873, 3899 (1995).

89/ In the Matter of Regulation of International Accounting Rates, CC Docket No. 90-337 (rel. Dec. 3, 1996) ("Flexibility Order").

90/ Flexibility Order ¶ 41.

91/ Id. ¶ 22.

Despite this emphasis on the marketplace, the Commission, in this proceeding, proposes to stifle, not promote, competitive forces. Such an approach is not only inconsistent with the Commission's market-oriented philosophy, but is also completely unnecessary.

B. The Success Of Market Trends And International Efforts Makes Unilateral Action Unnecessary

The success of international efforts and market forces make unilateral FCC action entirely unnecessary. Moreover, unilateral FCC action could thwart the very factors that have already reduced settlement rates by 48% in the past decade.

While the FCC expresses support for the efforts of international organizations that are working to lower accounting rates, it proposes to undermine these efforts by trying to single-handedly force other countries to lower their rates more quickly than they are willing to agree to. By unilaterally attempting to revise accounting rates, the FCC sends a signal that, in fact, it has scant respect for the international negotiation process or its participants. It prefers to dictate its own solution.

The NPRM tries to soften its criticism of international efforts by asserting that "significant technological and market changes"[92/] warrant its intervention. Such changes, the FCC states elsewhere, "accentuate the market distortions caused by above-cost settlement rates."[93/] Yet many of these very changes -- the products of increasingly competitive markets -- are beginning to put significant downward pressure on accounting rates, as discussed above. In other words, these market changes are the market's own self-correcting mechanisms. The FCC should accordingly allow these mechanisms to work.

92/ NPRM ¶ 18.

93/ Id. ¶ 12.

Moreover, assuming that some market innovations such as third-country routing and international call-back were truly unwelcome "distortions," the FCC's proposal would serve only to increase, not decrease their use. Specifically, a lower settlement rate means that the costs of routing a call through the United States are also lower, which in turn means that the price difference between a U.S.-billed international call and one billed in a foreign country is greater. Call-back services thus becomes even more attractive -- and will stay attractive so long as the foreign collection rates remain high. While these innovations will themselves put considerable pressure on collection rates, they will not completely succeed in making them competitive in many countries that still need to rebalance rates. Because, as discussed below, the pace of rebalancing depends on a variety of political and economic factors which are not within the FCC's control, any unilateral settlement rate reform must be tied to rate rebalancing.

C. The Commission Should Pursue Settlement Rate Reform Through The WTO And The ITU

Instead of adopting the unilateral approach espoused by AT&T, the Commission should pursue accounting rate reform through international organizations such as the WTO, the OECD and, most importantly, the ITU. These organizations are already working to ensure that accounting rate reform is both substantial and sustainable. In particular, the ITU is currently considering a wide variety of options for achieving long term accounting rate reform. One such option, which is endorsed by the OECD, is that the entire accounting system be replaced with a system of cost termination charges.[94/] Such proposals are slated to be addressed at the next meeting of the ITU's Working Group 3 in May.

[94/] Dr. Pekka Tarjanne, Speech: How Will the Accounting Rate System Need to be Modified in a Liberalized Market at 7 (Mar. 25, 1996).

Rather than proceeding unilaterally, the United States should instead redouble its efforts within the ITU to press for systemic reform. In this way, the United States would help to ensure that settlement rates are not only cost-oriented, but are also consistent with the unique demands posed by the telecommunications needs of individuals countries and regions around the globe.

D. The Commission's Proposal Does Not Address The Real Causes Of The Rising Settlement Imbalance

The Commission's proposals are not only inconsistent with market forces and international efforts, but they are also misdirected. More specifically, the Commission's proposals do not address the real cause of the rising settlements imbalance, which increased more than 270% from $1.8 billion in 1987 to $4.9 billion in 1995. This growth in the settlements imbalance is caused not by inflated settlement costs -- which have fell a staggering 48% during the same time period[95/] -- but by market innovations such as international call-back and country direct services through which calls originating in foreign countries are billed in the United States. Such services have grown rapidly in recent years, and now account for a large proportion of calls in many countries.

The proliferation of call-back services is a global phenomenon. In Latin America, Telefónica Internacional estimates that call-back services now represent as much as 20% of international outbound traffic in some countries. In Hong Kong, call-back has been responsible for an even more dramatic effect on the direction of traffic: where there used to be two minutes of inbound calls from the United States for

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95/ FCC, Accounting Rates For International Message Telephone Service Of the United States 6 (Jan. 1, 1997).

every one minute received in return, there are now seven.[96/] Even in Europe, the European Commission proposed legislation on January 29, 1997, at the request of member-state governments that will require U.S.-based call-back service providers to pay the value-added tax ("VAT"). The U.K. government alone estimated that its lost VAT revenues in 1996 amounted to $1 billion.[97/]

Indeed, call-back services are also proliferating even where they are clearly illegal. For example, in Peru, call-back services now account for about 8% of the market for international outbound services even though call-back is illegal, and even though it is illegal under U.S. law for U.S. carriers to provide call-back services in Peru.[98/]

The effect of call-back and country direct services on an index of U.S. settlements imbalance with the rest of the world can be seen in Figure 3 which shows the index of the "call ratio" between U.S.-billed minutes and foreign-billed minutes rising, the index of U.S.-billed minutes increasing, even as the index for average settlement payments drop.[99/]

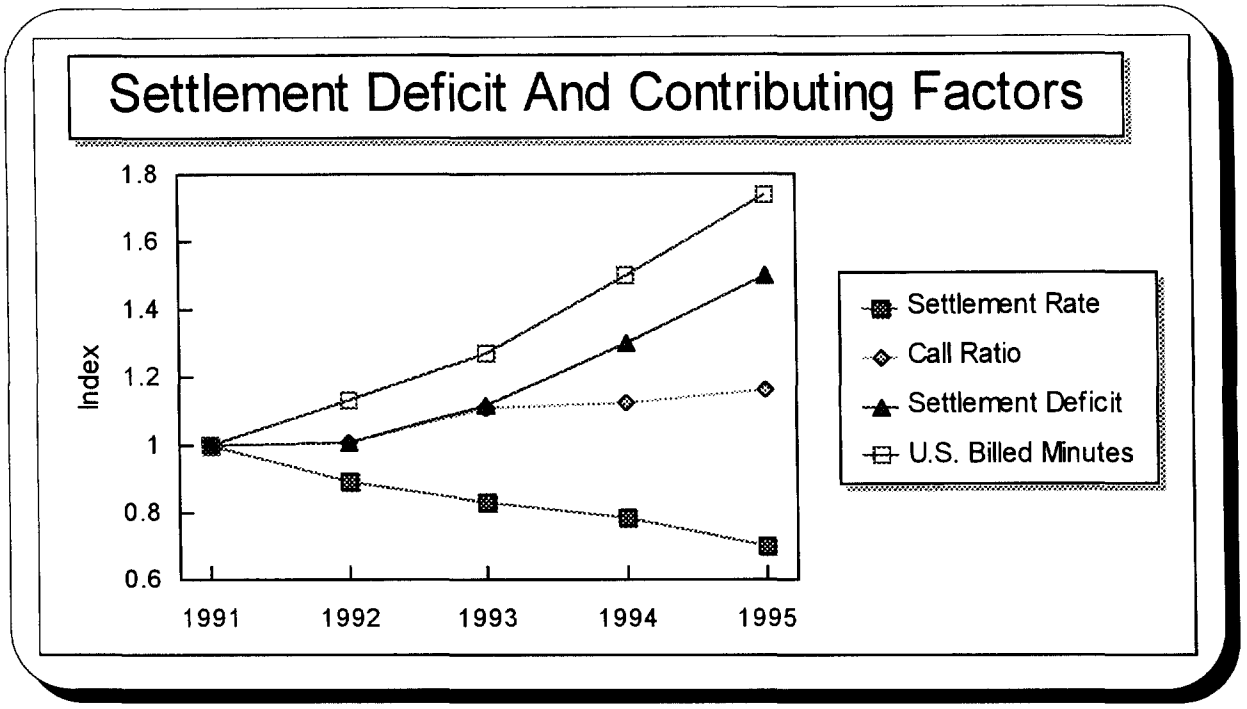
96/ Reed E. Hundt, Chairman, Federal Communications Commission, Address before the Institute for International Economics 4 (Oct. 23, 1996).

97/ 1997 Daily Tax Rep. (BNA) No. 20, at G-1, 2 (Jan. 30, 1997).

98/ In the Matter of VIA USA, Inc., Order on Reconsideration, 10 FCC Rcd. 9540, 9554 (1995).

99/ Data for this table come from FCC, "1991-1995 Section 43.61 International Telecommunications Data."

Figure 3



What is most striking about this graph is the complete divergence of the growing settlements imbalance and the shrinking average settlement rate. Clearly, there is no causal relationship. On the other hand, it is equally clear that the increase in U.S.-billed minutes and the increasing proportion of calls billed in the United States cause the U.S. settlements imbalance to increase.

The dramatic increase in call-back and other services originated abroad and billed in the United States that has led to burgeoning settlement deficits do not harm U.S. consumers, and provide enormous benefits to U.S. carriers. Call-back services do not harm U.S. consumers since they do not use them. For U.S. carriers, call-back and country-direct services have provided important new revenue streams and significantly increased profits. U.S. carriers have effectively entered the markets for international services in numerous countries around the world by providing call-back and country-direct services.[100/]

[100/] Dr. Pekka Tarjanne, Speech: How Will the Accounting Rate System Need to be Modified in a Liberalized Market at 3 (Mar. 25, 1996).

Unilateral settlement rate reductions would decrease the costs of call-back providers, encouraging greater use of call-back services abroad, thereby **increasing** the U.S. settlements imbalance. To reduce the settlements imbalance, settlement rate reductions must be tied to rate rebalancing.

V. ANY MANDATORY REDUCTIONS IN SETTLEMENT RATES SHOULD BE TIED TO RATE REBALANCING

AT&T's settlement rate proposal is likely to fail because it does not recognize the economic, political, or regulatory realities inherent in telephone rate systems throughout most of the world. Instead, if the Commission adopts unilateral requirements designed to reduce settlement rates,[101/] then it must tie any such reductions to rate rebalancing.

Most governments, including the United States, have a complex, delicate, and interrelated system of telephone rates for local, domestic long distance and international services.[102/] Many foreign governments use international telecommunication services to cross-subsidize domestic long distance and local services, for which foreign governments often mandate below-cost pricing. National governments design these rate systems to promote not only economic efficiency, but infrastructure development and universal service as well. There are substantial political forces opposed to rate rebalancing in many countries. By proposing sharp reductions in international settlement rates without regard to the need for corresponding rate adjustments in any given foreign country, AT&T has ignored these critical interrelationships.

101/ As mentioned above in Part IV, the FCC should pursue settlement rate reform on a multilateral basis.

102/ See, e.g., 47 U.S.C. § 254 (providing for universal service subsidies in the United States).

Instead of attempting to adjust settlement rates unilaterally without any corresponding adjustment in the foreign country's rate system, the Commission should tie settlement rate reductions to rate rebalancing. Most foreign carriers are already aggressively pursuing governmental approval to implement rate rebalancing in their countries because they have strong market incentives to do so. A plan that ties settlement rate reductions to rate rebalancing would fit with the economic, political and regulatory realities in foreign countries, and would align the Commission's goal of lower settlement rates with the foreign carriers' goal of rate rebalancing.

A. Significant Telephone Rate Rebalancing Is Necessary In Most Countries To Permit Substantial Decreases In Settlement Rates

The NPRM acknowledges that "carriers in many developing countries have significantly distorted rate schedules involving cross-subsidies from users of international services to those using domestic services."[103/] While these cross-subsidies are typically more pronounced in developing countries, they are present in virtually every country, including the United States, which uses cross-subsidies from international and interstate long distance services to support local services and universal service.

In many countries the cross-subsidies are so substantial that domestic services are priced well below cost. This is most obvious in Barbados, Hong Kong (a "High Income" country), and Kuwait, where the International Bureau Study notes that domestic services are free.[104/] These cross-subsidies, however, are in fact commonplace. In 56 of the 65 countries (86%) in the International Bureau Study,

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[103/] NPRM ¶ 61.

[104/] International Bureau Study at Appendix B, 17-18. As explained in Part VI below, the fact that domestic services are priced below cost makes the Commission's use of tariffed prices to determine costs inappropriate in many instances.

domestic long distance service is priced below the average U.S. long distance price of $0.16 per minute.[105/]

Cross-subsidies from international services are typically mandated by the government to support infrastructure investment and to promote universal service. The governments in many countries consider infrastructure investment and universal service to be more important goals than economic efficiency. Virtually no country in the world -- including the United States -- is willing to redesign their telephone rate system by focusing exclusively on economic efficiency and ignoring universal service and infrastructure investment.

In a country like Peru, where the telephone penetration was only 2.9 lines per 100 inhabitants in 1993, the Peruvian Government has naturally made upgrading infrastructure and increasing telephone penetration governmental priorities. Between 1994 and 1996, annual infrastructure investment has more than tripled, from $214 million to $680 million. Since the end of 1993, telephone penetration rates and number of access lines have more than doubled (from 2.9 to 5.9 lines per inhabitant and from 753,987 to 1,764,809 lines, respectively), and the waiting time for phone service has fallen dramatically from 70 to 1.5 months.[106/]

Indeed, the U.S. Government has taken a strong role in promoting infrastructure investment and universal service in foreign countries. At the 1994 ITU Development Conference in Buenos Aires, Vice President Gore successfully urged the Conference to adopt five critical principles for development of the Global Information Infrastructure ("GII"). These principles included promotion of private investment and

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[105/] International Bureau Study at Appendix B, 17-18; NPRM ¶ 9.

[106/] Data in this paragraph comes from Telefónica Internacional and Telefónica del Perú records.

universal service. In fact, Vice President Gore specifically praised Telefónica Internacional's infrastructure investments in Latin America:

> Adopting policies that allow increased private sector participation in the telecommunications sector has provided an enormous spur to telecommunications development in dozens of countries, including Argentina, Venezuela, Chile and Mexico. I urge you to follow their lead.[107/]

Out of all of the five principles, Vice President Gore stressed that:

> [t]he final and **most important principle is to ensure universal service** so that the Global Information Infrastructure is available to all members of our societies.[108/]

Vice President Gore explained that "[a] primitive telecommunications system causes poor economic development."[109/] While Vice President Gore also included competition as one of his five principles, he recognized that this goal must clearly be balanced against the other four, including "encourag[ing] private investment" and "ensur[ing] universal service," the "most important principle."[110/] AT&T's proposals, however, fail to balance the goal of promotion of competition with the other important goals of investing in infrastructure and universal access which are necessary for economic development in many foreign countries.

The NPRM's only concession to the other legitimate goals of foreign countries is a recognition that "[a]n immediate shift to cost-based settlement rates thus could create adjustment problems for carriers in these countries while they are trying to

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[107/] Gore ITU Speech at M-2.

[108/] Id. at M-3 (emphasis added).

[109/] Id. at M-3.

[110/] Id. at M-3. As explained in Part IV above, the NPRM falls short on the Vice President's competition goal by only striving for half of his objective to "adopt cost-based collection and accounting rates." Id. at M-3.

rebalance rates and upgrade their network."[111/] While acknowledging the problem, the NPRM understates the magnitude of the difficulties in many countries. It is the government, not the carrier, that establishes the rate structure in most foreign countries. Foreign governments can legitimately adopt national policies that promote telecommunications infrastructure investment and universal service at the cost of efficiency. Moreover, much greater telephone penetration and digitalization is required in many countries in order to maximize economic efficiency.[112/] In any event, this critical tradeoff between efficiency, equity and infrastructure investment is for the foreign government, not the FCC, to make.

The NPRM suggests that foreign carriers only need a Commission-specified transition period to make these specific adjustments.[113/] Foreign carriers, however, do not control the pace of rate rebalancing, foreign governments do. As the NPRM acknowledges elsewhere, "[a] number of countries, for example, are undergoing the politically difficult task of rebalancing rates."[114/] Indeed, even the United States is currently undergoing a major battle over how local access charges should be reduced toward costs in order to permit international and long distance collection rates to fall.[115/]

111/ NPRM ¶ 61.

112/ As pointed out in Part VI below, the NPRM's proposal to reduce settlements to TSLRIC would retard infrastructure development, universal service and economic efficiency, particularly in developing countries.

113/ NPRM ¶¶ 58-68.

114/ Id. ¶ 24.

115/ See comments filed in CC Docket No. 96-262.

Some countries require governmental approval to modify settlement charges.[116/] Even where foreign government approval is not required to reduce settlement rates, foreign carriers are often not in a position to make reductions until they are permitted to reduce their international collection rates and make corresponding increases in domestic rates. A decrease in the settlement rate reduces the costs of the competing U.S. carriers, permitting them to reduce their prices for the competitive call-back and country direct services.

For the foreign carrier, however, a reduction in settlement charges means a net revenue reduction. Moreover, a foreign carrier that reduces settlement charges without obtaining rate rebalancing cannot match price reductions to compete with the U.S. carrier offering call-back and country direct services. Even if the foreign carrier is permitted to reduce collection charges, such action may jeopardize its ability to fulfill its infrastructure and universal service obligations until the foreign government permits a broad rate rebalancing.

B. Foreign Carriers Have Strong Commercial Incentives To Rebalance Their Rates

Most foreign carriers, including Telefónica Internacional, are already aggressively pushing for rate rebalancing to make them more competitive. Even companies that have traditionally been the sole provider of international services in a country now typically face strong competition from U.S. carriers and others providing call-back and country direct services. For example, Telefónica Internacional estimates that approximately 20% of all outbound international calls are placed through call-back services in some Latin American countries. Foreign carriers throughout the world need rate rebalancing in order to avoid losing even greater market share to competitors.

116/ For example, in Peru, OSIPTEL, the regulatory agency, reserves the right to establish criteria pertaining to accounting rates.